

# STATE TEACHERS' RETIREMENT SYSTEM

## BILL ANALYSIS

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**Senate Bill 1945,**      **Senator Karnette**      (Amended 06/24/98)

**Position:**      **Co-Sponsor**

**Proponents:**      **STRS (co-sponsor), ACSA, ART, CFT, CRTA, CTA, FACCC, UTLA**

**Opponents:**      **Unknown**

### **SUMMARY**

SB-1945 would establish a 100% financing member home loan program under which STRS could loan up to 5% of the purchase price or value of the home, using up to 50% of the active member's retirement contributions as collateral. This personal 5% loan, combined with a 95% mortgage loan, provides 100% financing. The bill would limit loan amounts to the fair market value of the property, not to exceed \$350,000. Under this bill, personal 5% loans are authorized by the Teachers' Retirement Board (TRB), which may establish terms and conditions of the loans.

### **HISTORY**

AB-1872 (Chapter 392, Statutes of 1984) created the STRS Home Loan program and AB-1949 (Chapter 69, Statutes of 1986) enabled STRS to implement the program.

AB-2890 (Chapter 408, Statutes of 1988) authorized the TRB to add owner-occupied two to four family dwellings to the STRS Home Loan program.

SB-1171 (Chapter 543, Statutes of 1991) clarified the eligibility of STRS disabilitants and inactive members to participate in the STRS Home Loan program.

AB-2282 (Elder, 1992), vetoed by the Governor, would have required the TRB to conduct a study on the feasibility of offering members low interest rate home loans subsidized by trust fund moneys.

### **CURRENT PRACTICE**

STRS currently offers home loan financing, equal to up to 95% of the home's value, to assist eligible, active members to obtain homes in California. The member home loan provisions specify, in part, that loans shall not be made at below-market rates.

## **DISCUSSION**

SB-1945 would allow a greater number of members to purchase a home. Regardless of the economic forecast, the primary challenge to home ownership continues to be securing a downpayment. Inasmuch as retirement contributions are an "asset" of each member, it is appropriate for a member to use them as collateral for a home loan. In terms of the STRS Mission, this bill will demonstrate the System's genuine interest in members, prior to retirement.

Home loan financing is not a new concept or undertaking for retirement systems. Since November of 1994, the California Public Employees' Retirement System (CalPERS) has been offering 100% home loan financing. Under this program, PERS provides a mortgage of 95% of the home's value and extends a "personal loan" for the remaining 5%, using the member's PERS account as collateral. As of December 31, 1997, CalPERS processed 5,938 "personal loans," totaling \$34.6 million, or 45.5% of CalPERS' total loan portfolio.

Loan delinquency is a reality of every loan program. The loan delinquency rate for the personal CalPERS loans has been 6.69%. The delinquency rate for the mortgage loans in the CalPERS Home Loan Program is 4.36%.

STRS predicts a lower delinquency rate among its participating membership because STRS members typically have more stable employment than some CalPERS categories. STRS Member Home Loan defaults have normally been below 2%. In the event of a member's default, STRS would foreclose on the home and deduct the 5% personal loan from the member's retirement contributions, which would result in a corresponding reduction in the future retirement benefit. If, following foreclosure proceedings, the member borrower did not have sufficient equity in his/her home; the chances for a financial loss to the member are greater. Even with the risk of default to STRS and the members who would participate in this Program, staff believes it remains a prudent investment and an increased benefit to the membership.

Specifically, SB-1945 provides:

- the board may enter into correspondent agreements with private lending institutions
- defines the term "member" to mean any person who is receiving, or is entitled to receive, a retirement allowance funded by STRS

- requires the board to adopt specified regulations governing the program, including:
  - that home loans be made available to borrowers, including members, for the purchase of single-family dwellings, two-family dwellings, three-family dwellings, four-family dwellings, single-family cooperative apartments, and single-family condominiums
  - that the recipients of the loans occupy the homes as their principal residences
  - that the home loans be available only for the purchase or refinance of homes in this state
  - that the amount and length of the loans be pursuant to a schedule periodically established by the board that provide specific loan-to-value ratios of 95% for a first loan, (except for three- and four-unit dwellings, where the maximum is 90%); and up to 95% for each additional loan
  - that the portion of any loan exceeding 80 percent of value be insured by an admitted mortgage guaranty insurer in an amount so that the unguaranteed portion of the loan does not exceed 75 percent of the market value of the property together with improvements
  - that there may be prepayment penalties assessed on the loans
  - that the criteria and terms for its loans be consistent with the financial integrity of the program and the sound investment of the retirement fund
  - specify any other terms and conditions as the board deem appropriate
  - that this section be known as, and may be cited as, the Dave Elder State Teachers' Retirement System Home Loan Program Act.

In addition, SB-1945 declares that it is the intent of the Legislature that: (1) the bill's provisions be used to establish an investment program for residential mortgages, including assisting members in obtaining homes in this state, (2) that loans be secured primarily by the property acquired and shall not exceed the fair market value of the property acquired and (3) the board include in any investment program a procedure whereby a borrower may obtain 100-percent financing for the purchase of a single-family dwelling unit in accordance with the following criteria:

- (a) The member will obtain one loan with a loan-to-value ratio not to exceed 95 percent secured by the purchased home and a second personal loan with a loan-to-value ratio not to exceed 5 percent secured by a portion of the accumulated contributions and vested accrued benefits in the member's individual account. The 5 percent personal loan may only be used for the purchase of the member's principal residence and not for a loan to refinance;
- (b) The loan secured by the purchased home must be consistent with the loan-to-value ratios specified in the schedules established by the board;
- (c) In no event may the loan amount exceed three hundred fifty thousand dollars (\$350,000);
- (d) In no event may the personal loan secured by the accumulated contributions and vested accrued benefits in the member's individual account exceed the lesser of 50 percent of the current value amount of the accumulated contributions, or \$50,000; and
- (e) The pledge of security under this section will remain in effect until the loan is paid in full.

SB-1945 specifies that in the event of a default on the personal loan secured by the member's contributions, the board may deduct an amount from the member's contributions on deposit and adjust the member's accrued benefit, up to the amount pledged as security, prior to making any disbursement of retirement benefits.

Under the bill, the secured personal loan would be made available to members who meet eligibility criteria the board deems advisable. Also, if the member is married at the time the home is purchased with a personal loan secured by the member's contributions, then the member's spouse would agree in writing to the pledge of security, as to his or her community interest in the amount pledged. Also, in the event of default, the accumulated contributions in the member's account would be reduced as necessary to recover any outstanding loan balance, not to exceed the pledged amount.

SB-1945 allows appropriate administrative costs of implementing the program to be paid by the participating members. Those costs may be included in the loan amount. Also, appropriate interest rates would be periodically reviewed and adjusted to provide loans to borrowers consistent with the financial integrity of the home loan program and the sound and prudent investment of the retirement fund. Under no circumstances, however, would the interest rates offered to borrowers be below current market rate. The bill requires the

board to administer the program under other terms and conditions it deems appropriate and in keeping with the investment standard. The board may also adopt procedural guidelines as necessary for program administration and to assure compliance with applicable state and federal laws.

### **FISCAL IMPACT**

Program - No fiscal impact.

Administrative - SB-1945 provides that the administrative costs of implementing the bill shall be paid by participating members and that these costs may be included in the loan amount.

### **POSITION**

Co-Sponsor - SB-1945, which would allow for 100% home loan financing for members, would improve the loan program created in 1984, and greatly assist STRS members in obtaining home loans in California.